No. 169.

Brief of Davidge, Willcox & Davidge for P. E.

Office Supreme Court
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Supreme Court of the United States.

OCTOBER TERM, 1897.

Filed Dec. 15, 1897.

AMERICAN SURETY COMPANY OF NEW YORK,
PLAINTIFF IN ERROR,

vs.

FREDERICK N. PAULY, RECEIVER, &C.,
DEFENDANT IN ERROR.

No. 169.

BRIEF FOR PLAINTIFF IN ERROR.

W. D. DAVIDGE,
HENRY C. WILLCOX,
W. D. DAVIDGE, JR.,
For Plaintiff in Error.

WASHINGTON, D. C.:
GIBSON BROS., PRINTERS AND BOOKBINDERS.
1897.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1897.

AMERICAN SURETY COMPANY OF NEW YORK,
PLAINTIFF IN ERROR,
v.
FREDERICK N. PAULY,
RECEIVER.
No. 169.

In Error to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR PLAINTIFF IN ERROR.

STATEMENT OF THE CASE.

This action was commenced in the United States Circuit Court for the Southern District of New York on the 8th of May 1893, by Frederick N. Pauly, as receiver, the defendant in error, against the American Surety Company of New York, the plaintiff in error. (R. 5.)

The plaintiff below sued as receiver of the California National Bank of San Diego, California, to recover the

amount of a bond or contract for $25,000, issued by the Surety Company on the 1st of July, 1891, for the fidelity of the then president of that bank, one John W. Collins. By the terms of the contract the Surety Company undertook to answer for loss, by "fraud or dishonesty," of Collins. (R. 12.) It is set out at pages 11-16 of the record.

The obligation of the Surety Company was to make good and reimburse to the bank any pecuniary loss sustained by the bank by any act of fraud or dishonesty on the part of Collins in connection with the duties of his office. (R. 12.)

This obligation was, however, subject to the following conditions:

[1] "That the company shall be notified in writing, at its office in the city of New York, of any act on the part of the employee, which *may involve* a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act shall have come to the knowledge of the employer.

[2] "That any claim made in respect of this bond shall be in writing, addressed to the company, as aforesaid, as soon as practicable after the discovery of any loss for which the company is responsible hereunder, and within six months after the expiration or cancellation of this bond as aforesaid. And upon the making of such claim this bond shall wholly cease and determine as regards any liability for any act or omission of the employee committed subsequent to the making of such claim, and shall be surrendered to the company on payment of such claim.

* * * * * * * *

[3] "That if the company shall so elect, this bond may be cancelled at any time by giving one month's notice to the employer, and refunding the premium paid, less a *pro rata* part thereof for the time said bond shall have been in force, remaining liable for all or any default covered by this bond, which may have been committed by the employee, up to the date of such determination, and discovered and notified

to the company within the limit of time hereinbefore provided for.

[4] "That the employer shall, if required by the company, and as soon thereafter as it can reasonably be done, give all such aid and information as may be possible (at the cost and expense of the company), for the purpose of prosecuting and bringing the employee to justice, or for aiding the company in suing for and making effort to obtain reimbursement by the employee or his estate, of any moneys which the company shall have paid or become liable to pay by virtue of this bond.

* * * * * * * *

[5] "That no one of the above conditions, or of the provisions contained in this bond, shall be deemed to have been waived by or on behalf of the said company, unless the waiver be clearly expressed in writing, over the signatures of its president and its secretary, and its seal thereto affixed." (R. 13, 14, 15.)

The California National Bank of San Diego was organized in 1887, and commenced business in 1888. (R. 69.) In January, 1891, Collins, who had been cashier from the organization of the bank, became its president, and one George N. O'Brien, who had been a clerk, was appointed cashier. (R. 53.) On the application of Collins to the Surety Company the bond in question was given (R. 12), the limit of the liability being $25,000. (R. 14.)

On October 12, 1891, Collins was in New York city, and effected a loan from the Western National Bank of that city to the California Bank of $20,000. This loan was made on a note of the California Bank for $20,000, and on the security of promissory notes, the property of the California Bank, amounting to $36,250. The proceeds of the loan were credited by the Western National Bank to the California Bank, and subsequently drawn out by it. The loan was to the bank and not to Collins individually. (R. 78–81.) On the 13th of October, 1891, O'Brien, the cashier of

the California Bank, made out, in his own handwriting (R. 62), the deposit slip or tag marked Plaintiff's Exhibit No. 4, and set out at page 147 of the record, and on the same day the $20,000 on the deposit slip was entered by the bookkeeper of the California Bank to the credit of Collins' account in the ledger of the bank. (R. 63.) The $20,000 credit in the account is marked in the ledger "Western National." (R. 57.)

On the 12th of October, 1891, at the instance of Collins, the United States National Bank of New York city rediscounted for the California Bank two of their bills discounted, and placed the proceeds of the same to the credit of the California Bank. (R. 81.) The amount of the proceeds passed to its credit was $7,595.27. (R. 81.) On the 13th of October, 1891, the United States National Bank discounted the note of the California Bank for $17,500, and placed the proceeds to the credit of the California Bank. (R. 81.) The amount of both credits was checked out by the California Bank in the regular course of business. (R. 81.) Both credits were given by the United States National Bank to the California Bank, and not to Collins individually. (R. 81.) On the 13th of October, 1891, O'Brien made out, in his own handwriting (R. 63), the deposit slip or tag marked Exhibit No. 3, set out at page 147 of the record, and on the same day the $24,500 on the deposit slip was entered by the bookkeeper of the California Bank to the credit of Collins' account. (R. 63.) The $24,500 credit in the account is marked in the ledger "U. S. National." (R. 57.)

In each of the above transactions the proper entries to have been made upon the books of the California Bank by O'Brien were as follows: The $20,000 loan from the Western National Bank should have been placed to the credit of "bills payable" and charged to the Western National Bank. The actual entries are a charge to the

Western National Bank of $20,000, and a credit to the account of Collins of $20,000; "bills payable" is not credited with $20,000. The $24,500 loan from the United States National Bank should have been entered upon the books of the California Bank in the same way. There are no such entries. The actual entry is a charge to the United States National Bank of $24,500 and a credit of $24,500 to Collins individually. (R., 92, 93.)

It thus appeared that as a result of O'Brien's acts in filling up the deposit tags with statements which were apparently false, Collins's account with the bank was increased in his favor in the amount of $44,500. There was also another item in the account of Collins for $500 obtained from the United States National Bank in the same way, making in all $45,000 which appeared on the books of the California Bank to the credit of Collins. (R. 63, 147, 92.)

In the plaintiff's bill of particulars a number of other items were set forth, but under the ruling of the trial judge only these of the 13th and 14th of October were allowed to remain in the case, and it is only these that we have to consider. (R. 134.)

When the bank suspended payment, on the 12th of November, 1891, there was standing to his credit only $11,420.90. (R. 56.) This sum, deducted from the $45,000 credited, would leave a loss to the bank of $33,579.10.

There was also evidence that while before the date of the bond the account of Collins at all times showed a balance to his credit, he was, in fact, largely indebted to the bank by means of other similar apparently false entries which O'Brien had caused to be made.

The Surety Company, at the time it made the bond which is the subject of this suit, made a similar one in the sum of $15,000 to indemnify the bank against the misconduct of

O'Brien, the judgment on which latter bond is before this court for review—No. 168 at the present term.

The bank suspended payment on the 12th of November, 1891, and possession of its assets was taken by the bank examiner. (R. 38.) On the 18th of December, 1891, Pauly, the defendant in error, was appointed (R. 6), and, on the 29th of that month, qualified as receiver and took possession of the assets, books, and papers. (R. 38, 39.)

The bank, notwithstanding the fact that it had notice by means of the deposit tags and entries, as above mentioned, wholly failed to give the Surety Company the notice required by the first condition of the contract, "of any *act* on the part of the employee which *may involve* a loss for which the company is responsible hereunder as soon as practicable after the occurrence of such act shall come to the knowledge of the employer." (R. 13.)

The receiver also having, as he admits, knowledge of these acts of Collins and O'Brien, and being aware, as he swears, of acts that might involve a loss under the bond certainly as early as March, 1892 (R. 124), likewise failed to give the required notice to the company until the 1st of July, 1892, when he submitted to the company his proof of loss, notifying the company of these and other similar acts. (R. 57, 143–146.)

At the trial a letter from the receiver to the Surety Company, dated May 23, 1892, was given in evidence. (R. 89, 90.) It is set out in the record at page 166, marked Exhibit No. 24. The letter is nothing more than the general assertion of loss, and a request for blanks, so as to make claim for the loss in proper form; yet it was treated by the trial court as a compliance with the provision of the bond, requiring notice of any act of Collins which *might* involve a loss, and the court actually charged the jury that when the receiver became "satisfied" that

Collins had committed some specific act of fraud and dishonesty which might involve the Surety Company in loss, the letter of May 23d was a sufficient notice of such act. (R. 138.)

The letter is here set out in full in order that the court may see how far it is or ever was intended to be a compliance with the first condition:

"SAN DIEGO, CAL., *May 23rd*, 1892.

"AMERICAN SURETY COMPANY,
"160 *Broadway, New York, N. Y.*

"DEAR SIR: I write to notify you that the California National Bank held a bond to the amount of $20,000.00 in its favor for the faithful performance of duties by J. W. Collins, its late president, also in favor for the faithful performance of duties by Geo. N. O'Brien, its cashier, for $15,000.00. I therefore notify you that a discovery of fraud has been made of sufficient amount to require the payment of those indemnity bonds to the undersigned receiver of the California National Bank.

"I therefore ask that you forward us the necessary blanks to make the claim or claims in proper form.

"Respectfully, yours,
"FREDERICK N. PAULY,
"*Receiver.*" (R. 166).

Here are no acts notified, nor is the letter anything more than the general assertion of loss and a request for blanks, so as to make claim for the loss in proper form.

It is proper here to state that on an examination of the record it will be found that the receiver appears at no time to have recognized the duty of giving the notice required by the above condition, but to have supposed that the only notice to which the Surety Company was entitled was the claim for payment.

At the trial the question arose as to the proper construction of the condition of the contract requiring notice of

"any act on the part of the employee that may involve loss," or what is the same thing, *may* involve fraud or dishonesty.

In behalf of the Surety Company, it was contended that the duty to give such notice arose when any act of the employee, known to the employer, imported to any reasonable mind fraud or dishonesty, and hence might involve loss. On the contrary, it was contended on behalf of the receiver that the duty to notify did not arise until, on investigation, the employer had become "satisfied," or convinced, that fraud or dishonesty actually existed, and that any degree of suspicion, no matter how well founded, or well calculated to govern the action of a reasonable mind, did not give rise to the duty to notify. This question was determined by the trial court against the Surety Company. (R. 138.)

Another question determined by the trial court was whether or not what was "as soon as practicable" was to be determined by the jury. The court left that question to the jury (R. 138), whereas it was a question for the court to determine.

Although the duty of the receiver, as defined by the court, was made to depend on the discovery of acts of actual fraud or dishonesty, it was still necessary that he should give notice to the company "as soon as practicable" after discovery. No notice was, in fact, given of such acts until the claim or proof of loss, dated June 24, 1892, and received by the company July 1, 1892, was made. (R. 57; Exhibit 1, R. 143–146.)

By the contract it is provided that the statement of loss, based upon the accounts of the employer, shall be *prima facie* evidence. (R. 12, 13.) The trial judge held that this provision, which evidently referred to the consideration of the claim of loss by the company, did not stop there, but that in the event of the rejection of the claim of loss and a

subsequent suit against the company it worked a *prima facie presumption of the right to recover* in such suit, throwing the burden of proof upon the company. This ruling excepted to (R. 141) was affirmed by the Court of Appeals. (R. 279, 280.)

At the trial it was in evidence that the bond was obtained from the company by misrepresentations and fraud on the part of Collins. (R. 244.)

Other rulings were made at the trial principally as to the admission of evidence. These, so far as here insisted on, will appear in the assignment of errors.

Verdict and judgment for the plaintiff below. (R. 142, 150.) Affirmed on appeal. (R. 280.)

The bill of exceptions contains all the evidence in the case. (R. 252.)

ASSIGNMENT OF ERRORS.

There was error—

1. In the refusal to charge that, by the true construction of the contract, it was the duty of the bank, or receiver, to notify the Surety Company of any act on the part of Collins which, reasonably considered, *might* involve fraud or dishonesty in his office as soon as practicable after such act came to the knowledge of the bank or receiver. (R. 116, 125; 8th Request, R. 126); and in charging: "Now, it was not incumbent upon the plaintiff to give notice as soon as practicable after he may have had suspicions of dishonest conduct on the part of the president, but it was his duty when he became *satisfied* that the president had committed some specific act of fraud or dishonesty which was likely to

involve the defendant in loss to give notice in writing. * * * The notice in this case was given on the 23d of May, 1892, and it will become necessary for you to inquire and determine when it was that knowledge came to the plaintiff, when he became chargeable with knowledge that the president had committed some specific act of fraud or dishonesty likely to render the defendant liable upon its bond." (R. 138.)

2. In refusing to rule that, whatever the predicate of the duty to notify, whether as ruled by the court or claimed in behalf of the company, the company was not, as matter of law, "notified as soon as practicable of acts which might involve a loss." (R. 116, 125.)

3. In refusing to give proper instructions to enable the jury to decide the question of "as soon as practicable," as requested in behalf of the company as follows:

"If the jury find from the evidence that, on or before the 1st day of February, 1892, Mr. Pauly knew of any act of Collins which *might* involve a loss to the Surety Company under the bond in suit, then they must find a verdict for the Surety Company." (R. 126, 9th request to charge.)

"If the jury find upon the evidence that, on or before the 1st day of March, 1892, Mr. Pauly knew of any act of Collins which *might* involve a loss to the Surety Company under the bond in suit, then they must find a verdict for the Surety Company." (R. 127, 10th request to charge.)

"If the jury find upon the evidence that, on or before the 1st day of April, 1892, Mr. Pauly knew of any act of Collins which *might* involve a loss to the Surety Company under the bond in suit, then they must find a verdict for the Surety Company." (R. 127, 11th request to charge.)

If the jury find upon the evidence that, on or before the 1st day of May, 1892, Mr. Pauly knew of any act of Collins which *might* involve a loss to the Surety Company under the bond in suit, then they must find a verdict for

the Surety Company." (R. 127, 12th request to charge; (exceptions for refusing requests to charge, R. 141.)

4. In refusing the motion to dismiss the complaint on the ground that the receiver had not shown that a "proof of claim was served as soon as practicable after actual discovery of the loss, nor within six months after ex piration or cancellation of the bond." (R. 116, 125; exception, R. 117.)

5. In charging that, by the proper construction of the contract (R. 12, 13), the written statement of loss is made *prima facie* evidence of the right to recover in the action. (R. 135, 137; exception, R. 141.)

6. In charging that any written statement of loss based upon the accounts of the employer as provided by the contract was delivered to the Surety Company. (R. 135, 137; exception, R. 141.)

In respect of the last two assignments the court charged: "Now there is a provision in the policy to the effect that a written statement of loss certified by the duly authorized officer or representative of the employer (receiver of the bank in this case) and based upon the accounts of the employer, shall be *prima facie* evidence thereof. In view of that condition of the policy I instruct you that the plaintiff has established a *prima facie* case against the defendant because he gave the written statement of loss, and subsequently transmitted to the defendant a copy of the account upon which it was based. (R. 135; exception, R. 141.)

"Well, as I have said before, the plaintiff has made a *prima facie* case upon this issue [fraud or dishonesty] because he has complied with that condition of the policy which prescribes that a written statement of claim shall be

12. In refusing to charge:

"Even if the jury find that the credits of $25,000 and $20,000, for which the plaintiff seeks to recover, were fraudulently and dishonestly obtained by Collins, that alone does not make out the plaintiff's claim. He must show a loss resulted from these credits, and, in considering this latter question, the jury must not regard the alleged earlier false credits that have been given in evidence. *These earlier credits have no legitimate bearing upon the question of loss from the later ones.*" (R. 130; Exception 141.)

13. In refusing to charge:

"The jury cannot infer fraud or dishonesty upon Collins's part, in regard to any item here claimed, upon the theory that Collins was heavily indebted to the bank outside of such item or items. There is no legal or sufficient evidence that Collins was ever so indebted to the bank in any considerable amount." (R. 130; Exception, R. 141.)

POINTS AND ARGUMENT.

The facts in this case are similar to those in No. 168 at this term between the same parties, in which the questions of law relied on as error have been so fully argued, as to render much discussion here unnecessary.

POINT I.

The Duty to Notify the Surety Company as Soon as Practicable of any Act which May Involve Loss.

Both courts below held that the duty to notify was mandatory, and a condition precedent, failure to comply with which was fatal to recovery.

Both courts also held that the receiver, succeeding to the obligation of the company, took it *cum onere*, and was bound by the condition to notify.

These matters out of the way, it is proposed, briefly, to discuss, first, the *duty*, and, secondly, *whether it arose and was discharged.*

1. *The Duty.*

This is plainly a matter of construction. The parties competent to contract have made their contract, and the only question is what it means. It will be borne in mind that the contract relates exclusively to the relation of master and servant, employer and employee, the company undertaking to guaranty the fidelity of the president of the bank subject to the conditions of the contract.

First, the terms of the contract. They are perfectly plain.

The thing to be notified is the act—any act that *may* involve loss, not any act that *must* involve such loss. The duty depends exclusively upon the character of the act. It must be an act that may involve loss. As nothing but fraud or dishonesty can under the contract involve loss, the act must be such as *may* involve fraud or dishonesty. The act need not be in itself fraud or dishonesty ; it is sufficient if it may involve fraud or dishonesty.

What is the knowledge which is the postulate of duty ? Not knowledge of actual fraud or dishonesty but knowledge of any act that *may* involve fraud or dishonesty.

What is the act in the present case ? It is, in brief, the act of Collins appropriating to his own use the money of the bank through O'Brien, by means of false deposit tags and entries.

Is such an act one that *may* involve fraud or dishonesty ? It seems there can be but one answer.

Of course an act importing fraud or dishonesty may not be in fact what it imports. That, however, is not the question, but on the contrary the question is whether the act may be what it imports to be and hence *may* involve loss.

The duty depends upon the character of the act known to the employer and the natural and ordinary relations and consequences of such an act and how far in common experience it is consistent with the integrity of the employee. The theory of the courts below is that while an act, judged by any reasonable mind, may involve fraud or dishonesty, and hence loss, yet there was no duty to notify the guarantor until the employer, after investigation, has become satisfied of actual fraud or dishonesty. But the contract says that any act that *may* involve fraud or dishonesty shall be notified, not that it shall be investigated and then notified, or not, according to the conclusion reached by the employer.

The Surety Company contracted for notice of the act itself, not for its trial and determination by the employer and notice of the conclusion. The company was entirely competent to investigate for itself, and hence stipulated to be notified of the act, that it might investigate, if in its judgment necessary.

Secondly, the manifest intention and purpose.

Is there anything unreasonable in requiring knowledge of acts that may involve loss to be notified to a party interested? No one will say there is.

Was it not wise and prudent to require by the contract that the same acts which, reasonably judged, would cause the employer to investigate, should be notified to the guarantor, equally interested in those acts?

Again, the contract shows on its face *why* acts that might involve fraud or dishonesty were to be notified. The guarantor reserved the right to cancel the contract. (R. 14.) It

also bound the employer to co-operate with the company for the latter's protection, if required by the company to do so. (R. 14.)

How could these rights, the conditions of the obligation, be made available if the company was not promptly notified of acts which, to a reasonable mind, might involve fraud, but had to wait until an employer confessedly, confronted with such acts, had reached a conclusion as to actual fraud or dishonesty?

The courts below seem to consider that in the matter under discussion there can be only two states of the human mind—a state of "suspicion," in its narrow sense, where guilt is inferred from slight evidence, or no evidence at all, and a state of "satisfaction," or conviction of guilt. Acting upon this theory, they made "satisfaction" the standard of the duty to notify. Now, it is submitted, there is another state of mind between the above extremes, and universally recognized in human affairs, and that is the state where a reasonable mind, knowing an act and reasonably judging it, discovers that it may involve fraud or dishonesty. Such and no more is the standard of duty enacted by the contract.

The construction of the courts below practically nullifies the first provision of this bond, as to notice of any act that may involve fraud or dishonesty. The second provision, relating to claim of loss, necessarily involves acts of actual fraud or dishonesty. And yet the parties meant something by the first provision. What they meant is perfectly plain. By the first provision the company was, for its protection, to be notified of any act that might reasonably involve fraud or dishonesty. By the second the act, or acts, in fact, involving fraud or dishonesty were to be certified as part of the claim.

2. *Did the duty as here defined arise, and was it discharged?*

These are questions of fact, to be tried by a jury. They have not yet been tried.

a. Did the duty arise?

The evidence is simply overwhelming. Passing by the knowledge of the bank, to be implied from the false entries in the deposit tags and books, what is the evidence of the receiver himself?

He does not even deny knowledge of the above entries, nor that to his mind they might, and, indeed, did, involve fraud and dishonesty. He commenced an examination of the affairs of the bank immediately after he took possession (December 29, 1891). (R. 38–39, 124.)

He distinctly swears that he discovered the acts of fraud and dishonesty in February and March, 1892. (R. 124.) On January 27, 1892, he sent his report to the Comptroller of the Currency, including these items of the 13th and 14th of October, 1891. (R. 122, 123.) When he took possession, December 29, 1891, all the papers, including the books, checks, deposit tags, etc., upon which his case is based, were turned over to him. (R. 60, 61.) In the proof of claim he swears that on December 18, 1891, he was appointed receiver of the bank, and that immediately thereafter, "being advised that J. W. Collins, the then president of said association, was thought to be short in his accounts, and believed to have embezzled and misapplied funds of said association," etc. (R. 143.) On March 5, 1892, the Western National verified its proof of claim, which included one of the items making up this sum of $45,000. March 28, 1892, the receiver rejected the claims. (R. 236.)

His sense of duty led him to employ experts to examine the books of the bank so as to ascertain particulars and the extent of the loss. (R. 143.)

It must be clear that if the duty be as here defined, the receiver, unless phenomenally constructed, knew of acts that, reasonably judged and, indeed, as actually judged, by him, might involve fraud or dishonesty.

b. Was the duty discharged?

There is the same overwhelming evidence that it was not. There can be no pretence that if the duty be as here contended the company was not notified "as soon as practicable." The trial judge in his charge holding the duty to arise only when the discovery of actual fraud or dishonesty had been made by the receiver, ruled that any notice given as long as twenty-two days after discovery would not, as matter of law, be "as soon as practicable." (R. 139.) Apply that rule to the duty, not as erroneously defined by the court, but as plainly shown by the contract.

If the time in the charge is too short, or even if the question of "as soon as practicable" is not for the court but the jury, under proper instructions, still it follows that the company is entitled to a trial under a correct definition of the duty.

Indeed it is not saying too much to assert that the receiver, so far from discharging the duty, does not appear to have recognized its existence. He had two duties to discharge: one to give the notice of any act or acts, and the other to make the claim; the former a duty to the company, the latter to creditors and stockholders. Whilst active in the discharge of the latter, he seems to have had no conception of the former. He acted throughout as if the former were not in the contract, but the only duty was to make the claim of loss under the second condition. The claim of loss was not sent until June 24, 1892, and not received by the company until January 1, 1892. Hence the claim of loss would not in law be a compliance with the

duty to give the notice of acts even as that duty is defined by the court. The time between discovery and notice would not in law be "as soon as practicable" as charged by the court.

In this state of things, it was charged that as matter of law the letter of the 23d of May, 1892, operated as the notice. That letter, if examined, will be found to be in no sense a notice in pursuance of the duty even as that duty is defined by the court. It is simply a letter not referring to any act or acts of fraud or dishonesty, but stating generally that fraud has been committed so as to require the amounts guaranteed to be paid and asking for blanks to enable a claim of loss to be made in proper form. If such a letter be a compliance with the condition requiring the notice as defined by the court, such provision had as well be obliterated, for it can afford no possible protection to the company. The company is as much in the dark after the so-called notice as it was before. Even assuming, however, that the letter would be in law sufficient, according to the court's construction of the duty, no one can pretend that if the duty be as contended in this brief, the letter could be a fulfilment of it. Under the limit of time fixed by the charge as respects "as soon as practicable," it would manifestly be too late, for it is not open to controversy that the knowledge of acts that might, reasonably judged, involve fraud or dishonesty preceded by several months the discovery of actual fraud and dishonesty. At any rate, that question would be one of fact and for the jury.

POINT II.

IT WAS ERROR TO CHARGE THAT THE WRITTEN STATEMENT OF LOSS, FOLLOWED BY A COPY OF THE ACCOUNT UPON WHICH IT WAS BASED, CREATED A PRIMA FACIE PRESUMPTION THAT THE PLAINTIFF WAS ENTITLED TO RECOVER.

The theory of the court is based upon the following provisions of the contract:

"The company shall, within three months after notice, accompanied by satisfactory proof of a loss, as hereinafter mentioned, has been given to the company, make good and reimburse," &c. (R. 12, folio 29.)

"It being understood that a written statement of such loss, certified by the duly authorized officer or representative of the employer and based upon the accounts of the employer, shall be *prima facie* evidence thereof." (R. 12, 13, folio 30.)

"That any claim made in respect of this bond shall be in writing, addressed to the company as aforesaid as soon as practicable after the discovery of any loss for which the company is responsible hereunder." (R. 13, folio 33.)

It must be manifest that these provisions relate exclusively to the presentation of the claim to the company and the action of the latter thereon, and have not the remotest reference to a suit subsequently brought for the recovery of the alleged loss.

The company was willing in its consideration of the claim of loss to accept as *prima facie* evidence the statement duly certified and based upon the accounts of the employer instead of insisting on other proof.

The cardinal rule in the interpretation of contracts is the

intention of the parties as shown by the words, the subject-matter, and the object to be accomplished.

Now can it be asserted that, looking at these things, the parties intended anything more than to establish a reasonable rule in respect of the consideration of the claim by the company? Is it conceivable that the parties had any other intention?

Can it be supposed that they intended that an employer by making the statement, no matter how fraudulent or baseless, should be able thereby to deprive the company of its legal rights at all times and in all places, or that, in the event of the rejection of the claim of loss by the company for the best reasons, it might still be compelled to pay, not because the claim was just, but because of the alleged agreement?

The court will bear in mind that making the statement is the exclusive act of the employer, and in respect of it the company is utterly ignorant. Thus the penalty for *receiving* the statement of which it knows nothing is an admission of the alleged loss not only in respect of its consideration of the subject, but in any and all suits to which the rejection of the claim may give rise.

The Court of Appeals, affirming the ruling below on this subject, says:

"It [the contract] is *certainly open* to the construction put upon it by the trial judge; such construction is a *most natural* one; nor is there anything *extraordinary or startling* in an agreement by the company that it will pay *upon proof in a prescribed form* being made to it, nor in its agreeing to accept such proof as *prima facie* sufficient to entitle the insured to a recovery in case of default. Conceding that it is *also open* to a construction which would confine it as plaintiff in error contends, it would be at least ambiguous, and it is elementary law that all obscurities and ambiguities in a policy of insurance are to be resolved against the underwriter who has himself drafted the instrument."

It is submitted that the present, like any other contract, ought to receive a fair and reasonable interpretation; that the terms are plain, and that read by the subject-matter and manifest intention and object of the parties there is no ambiguity and that any ambiguity is only created by disregarding such subject-matter, intention, and object.

It does not clearly appear from the opinion of the Court of Appeals that that court recognized the full import and meaning of the ruling below. That ruling went to the extent that there was a *prima facie* presumption as to every element necessary to maintain the action—that the receiver had nothing to do at the trial but to give in evidence the statement, and was then entitled to recover unless the presumption was controverted by evidence given by the company. Thus the company was subjected to the *prima facie* presumption in respect of every element—notice, fraud or dishonesty and what not that entered into the right to recover.

Even if the *prima facie* presumption could have any application to a subsequent trial, which is denied, it does not admit of the forced construction put upon it by the trial judge. The statement which is to be *prima facie* is a statement "of such *loss* certified, &c., and *based upon the accounts of the employer*. Now, can anything be clearer that what the parties contemplated was that the statement transmitted to the company should be *prima facie* evidence of the *amount* or *extent of pecuniary loss* alleged? Surely such, and such only, was intended.

The ruling, however, instead of stopping here, makes the *prima facie* presumption extend to and comprehend every element of law and fact entering into the right to recover. The ruling makes the legal effect of the statement practically a confession of judgment subject only to the privilege of avoiding judgment by proving *negatives*—that is, there

was no fraud or dishonesty, actual loss, no notice, no pecuniary loss as alleged, &c.

It is worthy of observation that by the contract the statement is required to be "based on the *accounts* of the employer." (R. 12, 13.) The account of Collins with the bank is set out at R. 223–228. This account was never sent to the company. A so-called account was sent July 18, 1892 (R. 174; Exhibit 39, R. 181), nearly a month after the claim of loss. This latter consists simply of a paper showing the reconstruction and manipulation of the book account by the receiver and his aid Bloodgood, the result of which was to swell the account so as to show a balance against Collins of $374,978.22. (R. 110, 111.)

Thus we have an illustration of the doctrine of *prima facie* presumption laid down by the court. It gives *prima facie* force and effect in respect of law and fact to anything the employer may think fit to claim.

POINT III.

THE QUESTION OF WHETHER NOTICE OF ACTS THAT MIGHT INVOLVE LOSS WAS GIVEN AS SOON AS PRACTICABLE, WAS FOR THE COURT.

The ground upon which it was left to the jury was the erroneous assumption that the letter of May 23, 1892, was as matter of law the notice required (R. 138), but this letter, the construction of which is for the court, is manifestly not the notice required, nor was it intended to be such.

Apart from the letter there is no pretence of notice except by the claim of loss, dated June 24, 1892, and received

by the company July 1, 1892, and even if such claim can be made to operate as such notice, it would be too late, as ruled by the trial judge in his charge. (R. 139.)

POINT IV.

THE CLAIM OF LOSS WAS NOT GIVEN TO THE SURETY COMPANY WITHIN THE LIMIT OF TIME PROVIDED.

By the contract the company agrees, three months after notice accompanied by satisfactory proof of loss has been given, to make good and reimburse. (R. 12.) This notice "shall be in writing, addressed to the company, as aforesaid, *as soon as practicable* after the discovery of any loss for which the company is responsible hereunder, and *within six months* after the expiration or cancellation of this bond as aforesaid." (R. 13.)

The bond expired by its limitation of one year and also by the "death, dismissal, or retirement of the employee from the service of the employer;" and, within six months thereafter, the claim of loss was required to be made. (R. 12, 13.)

The bank suspended on the 12th of November, 1891. The receiver was appointed on the 18th of December and qualified and took possession on the 29th of that month. (R. 124.)

Collins ceased to act as president on the 12th of November, 1891. This is the sworn statement of the receiver and indeed is the only evidence on this point in the case. (R. 124.)

The claim of loss accompanied by proofs, dated the 24th of June, 1892, was not received by the company until the

1st of July, 1892. (R. 57.) Thus it plainly appears that more than six months elapsed before claim of loss was given.

It needs no argument to show that the limit of time fixed by contract could not be extended save by mutual consent especially in the case of a surety, nor that if it could the evidence afforded any pretext for the jury to absolve the receiver from the contract.

All the evidence as to the dismissal or retirement of the employee was the evidence of the receiver himself, that—

"The following is the date of the dismissal or retirement of said John W. Collins * * *

"The said J. W. Collins ceased to act as president of the said California National Bank upon the same going into insolvency and coming into the possession of the Comptroller of the Currency of the United States, which took place December 12, 1891." * * * (R. 124.)

POINT V.

ERRORS WERE COMMITTED IN THE ADMISSION OF EVIDENCE.

We cannot undertake to argue in detail the questions of evidence presented by the record. There are, indeed, but few that space will permit us even to notice:

1. The admission in evidence of Collins's ledger account, and of the teller's book, as it was called.

2. The admission of evidence as to alleged prior frauds.

3. The admission of evidence claimed to show the extent of Collins's indebtedness to the bank.

1. *The ledger account and the teller's book.*

Keeping in mind the theory of the plaintiff's case, that

the acts of fraud and dishonesty consisted in the false *credits* in Collins's account which he is alleged to have drawn out, how can *the entire account* be evidence against his surety?

It certainly could not of itself be evidence of anything. It does not prove itself. It is but a series of declarations by which the surety cannot be affected, much less bound. It would not be evidence even against O'Brien or Collins.

Rudd *v.* Robinson, 126 N. Y. 117.
Smith *v.* Rentz, 131 N. Y. 175–6.

And it certainly could not be evidence against the surety.

Hatch *v.* Elkins, 65 N. Y. 489.
Roe *v.* Beach, 76 N. Y. 168.

If not evidence, in and of itself, it never was made evidence by any further testimony. The rule requires entries to be proved by the person making them and having personal knowledge of the facts asserted by them. No rule is better settled than this; but no such testimony was given. The only witness put on the stand as to the ledger account testified that he had no personal knowledge of the transactions represented by the entries (R. 55), and did not even make all the entries. (R. 55.) But, in spite of our objections, he was allowed to read from the account as much as plaintiff desired (R. 56–58), and this account was *the only evidence* that Collins *ever drew out anything.* We submit that it was wholly insufficient.

The same considerations apply to the teller's book. R. 64.)

Admitting, however, that the books were evidence as against the Surety Company, if properly proved, the testimony was to the effect that the books did not contain a true account of the transactions of Collins with the bank.

Brimhall, the bookkeeper, testified that the account of Collins was used as a "clearing house" (R. 70); that his account was used for many transactions of the bank in which he had no interest (R. 71); that his account contained items not properly chargeable against him (R. 70); that his account was used for the purpose of getting a transaction off the books which had been placed there for the convenience of the bank (R. 71); that there were transactions in Collins's name for the benefit of the bank (R. 72); that to pass things into his account and out of his account that were really for the interest of the bank, and not Collins's, was an every-day transaction. (R. 71.)

Not only this, but after the suspension certain additional items were entered in the account. (R. 56.)

Indeed, in the plaintiff's own case the account must have been discredited, for the account shows and the bookkeeper testified (R. 51) that at the suspension of the bank Collins had a credit of $11,420.90. (R. 56.) It is only on the theory of Collins's indebtedness to the bank that it is made to appear that Collins drew out the $45,000 improperly placed to his credit. Moreover, if we take the two bonds together, one in this case for $25,000, and one in the O'Brien case for $15,000, No. 168 at this term, making $40,000 in all, and deduct from the alleged loss, $45,000, the credit in favor of Collins for $11,420.90, we have as a result $33,679.10, while the plaintiff sued for and recovered a judgment for the full amount of both bonds. It was only by discrediting the account that the plaintiff maintained his case. That is why he notified the company that Collins's account was overdrawn to the extent of $374,978.22. (R. 174, 181–209.)

2. *Evidence as to alleged prior frauds.*

Mention has been already made that plaintiff was allowed to prove alleged frauds prior to the date of our bond. There were many instances of this, one or two examples of which will be sufficient. On March 25, 1891, the Park Bank of New York loaned $25,000; and on June 10, 1891, $20,000 to the California Bank. (R. 75, 77.) These sums, it is claimed, were by deposit tags credited to Collins. (R. 75.) Even conceding that, for argument's sake, how could it properly affect the surety? Our bond was not given until July 1, 1891. (R. 11.) The urgency for it all is apparent. By the books of the bank—this very ledger account—Collins still had $11,420.90 to his credit when the bank closed its doors. To make out his case it was necessary for the receiver to strike out some of the credits, thus impeaching the account, and at the same time to insist that *the entries on the other side* were *per se* evidence, even against the surety, of Collins having drawn out money.

Now, we submit that all this was error. If these items are *not* necessary in proving that *during the life of our bond* Collins was allowed to draw out more money than was his right, then, however fraudulent it may have been, it was improper to admit it to our prejudice with the jury.

If they *were* necessary to the establishment of any loss, then the loss was one for which the surety was not liable. We did not undertake to answer for O'Brien's acts done before the bond was given.

Still further, even if we could in any way be *liable* under the bond for these alleged prior frauds, then we were *entitled*, under the bond, *to have them specified in the proof of loss.* This was not done. All these objections were taken, and the admission of the evidence was, we submit, error.

3. *The extent of Collins's indebtedness to the bank.*

The error in this was twofold.

a. Its amount had no legitimate bearing on the case.

The surety was only liable for "fraud and dishonesty," not for "indebtedness." The charge was "false entries," and improper certificates of deposit. If, on any particular day, Collins gave value to the bank, he was *entitled* to a credit to that amount or to a certificate of deposit, as he might elect, *no matter how much he then owed the bank.* The bank could not take his money save on his own terms. The only question, then, under the proof of loss, the complaint or the bill of particulars, was whether he did or did not give value in the case of the particular items on which a recovery was sought. His general indebtedness had nothing legitimately to do with that inquiry.

b. There was no competent evidence showing how much Collins did owe the bank, and incompetent evidence on that subject was admitted. The receiver claimed to have sent to the surety a certain account showing the true condition of affairs between Collins and the bank. (R. 174.) It was at last received in evidence. (R. 181.) It makes out Collins a debtor in $374,978.22. How did sending it to the surety make it competent evidence against the latter, that Collins owed the bank $374,978.22? The receiver relied on a phrase in the bond as to "*prima facie* evidence." (R. 12–13.) That clearly refers to a prior part of the bond, which says that the notice must be accompanied by "satisfactory proof of a loss, as hereinafter mentioned." (R. 12.) The bond, therefore, proceeds, later on, as promised, to say in what form this *preliminary* proof must be. The parties are not speaking of a possible subsequent trial of an action. No such contingency is in their minds.

Moreover, the statement which is to be "*prima facie* evidence" is a statement of the "loss," for which claim is made. It is not pretended that the receiver could, or ever did, claim $374,978.22 under the bond. This is a statement of Collins's alleged aggregate indebtedness to the bank, and not of the "loss" claimed from the surety. How, then, can it be evidence against the latter?

Surely it is idle to stop to argue that this remarkable document was not evidence against the surety, that Collins owed the bank $374,978.22, even if—which we have already disputed—that fact, legitimately proved, would have been competent. The surety did not agree that a statement of such composite parentage—not merely not "based" upon the employer's account, but assuming upon outside investigations to impeach them—should be evidence of anything against him.

An inspection of this statement and the testimony of the bookkeeper, Bloodgood, who made it up, shows that it presents the ideas of the receiver, his counsel, and his bookkeeper, rather than the facts (R. 110, 111); and that it is composed of items which they, in their judgment, thought best to charge against Collins, with the apparent purpose of making the account show as much as possible against Collins; and to that end utterly disregarded the account of Collins in the bank's books, which account shows that the bank owed Collins $11,420.90 on the date of its failure. (R. 56.) Thus the receiver takes the position on one hand that the books and Collins's account are correct and competent evidence against the surety, and on the other that the books are not correct, and that a statement of Collins's account may be made up from outside information, papers, &c., and, when so made up, will bind the surety and make out a "*prima facie*" *case* against the defendant and justify the jury being so instructed as well as that it is thereupon for the surety to "overcome that case."

In respect of other errors the Court is respectfully referred to the argument in the preceding case, No.168 of this term.

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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